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# THE EFFECTIVE DISCLAIMER\*

George M. Schain\*\*

A disclaimer<sup>1</sup> is a refusal to accept the benefits of property whether given by *inter vivos* gift, testamentary transfer, or intestacy.<sup>2</sup> Such a waiver of property rights can be very valuable to an estate planner, but if incorrectly done can create serious income, gift, and estate tax problems.<sup>3</sup>

The use of disclaimers is deeply rooted in the laws of many societies.<sup>4</sup> It was based on the theory that a person should never be forced to accept the burdens of ownership of property without his consent.<sup>5</sup> A valid disclaimer under current federal law treats the transfer as if the disclaimant had predeceased the transferor,<sup>6</sup> thus permitting the disclaimant to avoid any subsequent tax liability he or she might incur from transferring the unwanted piece of property to another.

We have come a long way from the ancient conveyances of Blackacre where the only purpose of renouncing property was to remove the burdens of owning it. Today, although the original purpose may still exist in many instances, the disclaimer has evolved into a manipulative tool that can provide many benefits for the disclaimant and his family. Since the disclaimant

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\* The author's forthcoming book, *ESTATES, GIFTS & TRUSTS TAXATION & PLANNING* (Garland Pub. Co, N.Y., N.Y.), will contain an adaptation of the materials presented in this article.

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1. At common law and in some state statutes a disclaimer is referred to as a renunciation. Aside from the limitations and variations placed upon a renunciation by the various jurisdictions, the term is equivalent to a disclaimer.

2. See, e.g., *Brown v. Routzahn*, 63 F.2d 914 (6th Cir.), cert. denied, 290 U.S. 641 (1933) (permitting disclaimers of interests created by inter vivos and testamentary transfers). See generally Proposed Treas. Reg. § 25.2518-2(d)(2) (1980) (local law stating that intestate property vesting immediately upon death of decedent has no bearing on federal acceptance requirements).

3. This article will not explore the specific income tax problems arising in the context of disclaimers. The reader should, however, be aware that an improperly executed waiver of a property right may raise some troublesome income tax issues. For example, there are potential anticipatory assignment of income problems if income has accrued to the subject property between the date of the attempted transfer to the transferee and his subsequent rejection of it.

4. See Martin, *Perspectives on Federal Disclaimer Legislation*, 46 U. CHI. L. REV. 316 n.2 (1979).

5. *Townson v. Tickell*, 106 Eng. Rep. 575, 576-77 (K.B. 1819) (Abbott, C.J.).

6. Proposed Treas. Reg. § 25.2518-1(b) (1980); I.R.C. § 2518(a) (1984).

is treated as never having owned the property, an effective disclaimer may be used to avoid creditors,<sup>7</sup> or to prevent increasing an already healthy-sized gross estate. It can also be used, in some instances, to give a disinherited child some of the decedent's property, thus softening the blow of a harsh will and smoothing over family relations.

Unfortunately, codifying a common law principle into the Internal Revenue Code<sup>8</sup> (Code) has created many problems. The questions of what may be disclaimed, how it may be disclaimed, and when it may be disclaimed have proven to be quite enigmatic to the estate planner.

This article will trace the evolution of the disclaimer from common law through the implementation of section 2518 of the Code and the proposed regulations thereunder, and finally to the most recent change set forth in the Economic Recovery Tax Act of 1981.<sup>9</sup> The development will show the inconsistent treatment given to taxpayers under this section, and hopefully will provide some insight into and guidance for the future use of federal disclaimers.

## I. PRE-SECTION 2518 FEDERAL DISCLAIMERS

Prior to the enactment of section 2518, disclaimer laws were dispersed throughout various sections of the Code. For example, to determine the effect of a disclaimer by a surviving spouse on the estate tax marital deduction it was necessary to refer to section 2056;<sup>10</sup> for a disclaimer of a general power of appointment, sections 2041(a)(2)<sup>11</sup> (estate tax) and 2514(b)<sup>12</sup> (gift tax) had to be consulted; for a disclaimer that would result in the interest passing to a charity, section 2055(a)<sup>13</sup> was to be considered.

After examining the appropriate section to see how a specific interest was treated, the potential disclaimant then had to look to section 2511, or more

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7. See Proposed Treas. Reg. § 25.2518-1(c)(2) (1980). Local law, however, must be examined to see whether a disclaimer can avoid creditors' claims.

8. Tax Reform Act of 1976, Pub. L. No. 94-455, § 2009(b)(1), 90 Stat. 1520, 1893 (codified at I.R.C. § 2518).

9. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 172 (codified as amended in I.R.C.) [hereinafter cited as ERTA].

10. Prior to 1966, I.R.C. § 2056(d) did not allow for an estate tax marital deduction when a third party disclaimed an interest passing from a decedent that then passed to the decedent's surviving spouse by virtue of the disclaimer. This section was later repealed by the Tax Reform Act of 1976, *supra* note 8, § 2009 (b)(4)(D), at 1894.

11. I.R.C. § 2041(a)(2) (1976) provides that "[a] disclaimer or renunciation of such a power of appointment shall not be deemed a release of such power."

12. See I.R.C. § 2514(b) (1984); Treas. Reg. § 25.2514-3(c)(5) (1983).

13. I.R.C. § 2055(a) (1984) allows an interest passing to a qualified charity as a result of a disclaimer to be eligible for a charitable deduction.

specifically to treasury regulation section 25.2511-1(c),<sup>14</sup> to delimit the mechanical procedures of renouncing a property interest. Treasury regulation section 25.2511-1(c) still governs disclaimers for interests created prior to 1977.<sup>15</sup> To effectively renounce property under this section, the refusal to accept must (1) be unequivocal, (2) be effective under local law, (3) occur before there is an acceptance, and (4) occur within a reasonable time.<sup>16</sup> Although simple on its face, section 25.2511-1(c) posed many problems concerning the interpretation of these four factors.<sup>17</sup>

### A. The Local Law Element

Since the regulation explicitly stated that a federal disclaimer must be valid under local law, a federal disclaimer effective in one state might be ineffective in another. An example of this varying treatment is the traditional common law distinction between property inherited by intestacy and that received through a will. Many state statutes and court decisions declared that persons were not able to disclaim property to which they had already acquired title. Hence, testate property could be disclaimed because the donee had not yet received title, and therefore had the right to refuse.<sup>18</sup> Conversely, some states declared that intestate property passes by operation of law and thus title vests immediately upon the donor's death. As a result,

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14. Treas. Reg. § 25.2511-1(c) (1983) provides in pertinent part:

Where the law governing the administration of the decedent's estate gives a beneficiary . . . a right to completely and unqualifiedly refuse to accept ownership of property transferred from a decedent . . . a refusal to accept ownership does not constitute the making of a gift if the refusal is made within a reasonable time after knowledge of the existence of the transfer . . . . Where the local law does not permit such a refusal, any disposition . . . constitutes the making of a gift . . . .

*Id.*

15. Since I.R.C. § 2518 was enacted prospectively, § 2511 still applies to all interests created prior to January 1, 1977. Section 2518 of the Code applies to all interests created after December 31, 1976, while the ERTA amendment to the section can only be applied to disclaimers of interests created after December 31, 1981.

16. Treas. Reg. § 25.2511-1(c) (1983).

17. Not discussed in this text are the concepts of acceptance and unequivocal refusal that also created interpretive problems. Treasury regulation § 25.2511-1(c) provides that "there can be no refusal of ownership of property after its acceptance." This poses serious problems, particularly when the taxpayer attempts to disclaim his interest in a joint tenancy. *See Krakoff v. United States*, 439 F.2d 1023 (6th Cir. 1971) (the court disallowed a renunciation of an interest in a bank account creating a joint tenancy with a right of survivorship). In *Krakoff*, the court said that state law dictated that the surviving joint tenant had accepted a property interest upon the creation of the joint tenancy and could not disclaim. *Id.* at 1027. *But see* *Hershey v. Bowers*, 7 Ohio St. 2d 4, 218 N.E.2d 455 (1966) (there was no acceptance of benefits when the surviving joint tenant had no knowledge of the existence of the joint tenancy). Treas. Reg. § 25.2511-1(c) also provides that a refusal must be unequivocal.

18. *See, e.g., Brown*, 63 F.2d at 914.

the donee/disclaimant has automatically become legal titleholder and cannot refuse the property.<sup>19</sup>

Two cases highlighting the distinction between testate and intestate property and their inconsistent treatment at the federal level are *Brown v. Routzahn*,<sup>20</sup> and *Hardenbergh v. Commissioner*.<sup>21</sup> In *Brown*, the recipient of three separate interests by will retained two of these interests and disclaimed the third.<sup>22</sup> The United States Court of Appeals for the Sixth Circuit held that the property was not includable in the disclaimant's estate<sup>23</sup> because the renunciation was not considered a transfer and consequently was considered a valid rejection of the interest.<sup>24</sup>

In *Hardenbergh*, a surviving spouse and her daughter attempted to disclaim their intestate shares so that the decedent's last requests expressed in an unexecuted will could be granted. The Tax Court held, and the Sixth Circuit affirmed, that since the will was unexecuted, the decedent had died intestate, and therefore under local law intestate shares vested immediately upon the decedent's death. Hence, the mother and daughter received their shares by operation of law and could not disclaim their respective interests since title had already been deemed vested.<sup>25</sup>

Not only did section 25.2511-1(c) mandate that state law should be consulted to determine what interests may be disclaimed under local law, but it may also be inferred that the procedures for disclaiming an interest under local law must also be followed to make an effective federal disclaimer. This posed little problem until the disclaimant was faced with a situation in which the state procedure varied from the federal requirements of section 2511. Federal courts have generally dealt with this problem by incorporating state law definitions into federal law.<sup>26</sup> In *Brown*, the court apparently disre-

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19. See, e.g., *Hardenbergh v. Commissioner*, 198 F.2d 63 (8th Cir.), cert. denied, 344 U.S. 836 (1952). Although this common law rule was found in most jurisdictions, many state legislatures have abolished this rule through implementation of state statutes allowing for the disclaimer of an intestate share. See Martin, *supra* note 4, at 319 n.12.

20. 63 F.2d 914 (6th Cir.), cert. denied, 290 U.S. 641 (1933).

21. 198 F.2d 63 (8th Cir.), cert. denied, 344 U.S. 836 (1952).

22. *Brown*, 63 F.2d at 914-15. The disclaimer in *Brown* was made eight years after the death of the testator but prior to distribution. Since this was allowable under local law, the court did not address the question of timeliness at the federal level. *Id.* at 916. For a discussion of effectiveness under local law and timeliness as they relate to federal disclaimers of interests created prior to 1977, see *infra* notes 26-47 and accompanying text.

23. *Brown*, 63 F.2d at 917. The disclaimant died subsequent to the disclaimer and the Internal Revenue Service attempted to include the property in the disclaimant's estate as a transfer in contemplation of death. *Id.* at 915-16.

24. *Id.* at 917.

25. *Hardenbergh*, 198 F.2d at 65-66.

26. See, e.g., *Cottrell v. Commissioner*, 628 F.2d 1127, 1129-31 (8th Cir. 1980). For a discussion of *Cottrell*, see *infra* notes 37-39 and accompanying text.

garded the fact that the disclaimer was made eight years after the decedent's death by declaring that the disclaimer was effective under local law.<sup>27</sup> Conversely, in *Keinath v. Commissioner*,<sup>28</sup> the United States Court of Appeals for the Eighth Circuit said that although necessary, mere effectiveness under local law was insufficient to validate a federal disclaimer.<sup>29</sup> Thus the loosely drafted state statute<sup>30</sup> left the proposed disclaimant with no guidance when confronted with the problem of contradicting procedural sections at the state and federal levels.

Courts following the *Brown* rationale interpreted section 2511 as stating that a disclaimer, procedurally sound at the local level, was enough to satisfy the federal requirements. Jurisdictions adhering to the *Keinath* rationale, however, held that the disclaimer must be effective under local law, but the federal requirements must also be considered. In any event, as the state laws varied, so did the treatment of the taxpayer under federal law.

### B. The Reasonable Time Element

Perhaps the greatest problem with disclaimers of interests created prior to 1977, and the most important reason for section 2518,<sup>31</sup> was the requirement that all federal disclaimers must be made within a reasonable time. As in torts, the question of what is reasonable invariably caused many problems for the trier of fact.

Treasury regulation section 25.2511-1(c) declared that the time period for an effective disclaimer commenced "within a reasonable time after knowledge of the existence of the transfer." In *Keinath*, the taxpayer was given a vested remainder subject to divestiture of an income interest in a trust that was initially conveyed to the decedent's widow for life.<sup>32</sup> Nineteen years after the original transfer, the widow died thereby vesting the taxpayer's remainder interest. Shortly thereafter the taxpayer disclaimed his now fully vested interest. The government disallowed the disclaimer asserting that nineteen years was not a reasonable time in which to disclaim an interest.

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27. *Brown*, 63 F.2d at 915. See *supra* note 22.

28. 480 F.2d 57 (8th Cir. 1973).

29. *Id.* at 60-62. The court nevertheless applied state law as to timeliness by stating that the Code and regulations did not define "reasonable time." Thus, the state law definition of timeliness was applied. *Id.* at 62.

30. See *id.* at 61.

31. JOINT COMM. ON INTERNAL REVENUE TAXATION, GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1976, H. REP. NO. 658, 94th Cong., 2d Sess. 590, reprinted in 1976 U.S. CODE CONG. & AD. NEWS 2897, 3420-21 [hereinafter cited as JOINT COMM. ON INTERNAL REVENUE TAXATION].

32. *Keinath*, 480 F.2d at 57.

The Tax Court found in favor of the government<sup>33</sup> and the taxpayer appealed. In a now famous opinion, the Eighth Circuit reversed the Tax Court's finding that the taxpayer had knowledge of the beneficial interest and, therefore, should not be allowed to disclaim said interest nineteen years after the fact. The court held that since the interest was subject to divestiture, the disclaimer was allowable if made within a reasonable time after the interest became indefeasibly vested.<sup>34</sup> It further stated, however, that present interests and future interests not subject to divestiture must be disclaimed within a reasonable time after the interest is created.<sup>35</sup>

In its analysis, the court held that the remainderman had not received any present benefits or control of the property before the interest became irrevocably vested. Thus, although there was a possibility of future benefits during the nineteen year period, there was no disclaimable interest.<sup>36</sup>

In 1980, the Eighth Circuit addressed the *Keinath* problem once again. The case of *Cottrell v. Commissioner*<sup>37</sup> was factually distinguishable from *Keinath* only because the children received a testamentary power of appointment in addition to their remainder interest, which allowed them to dispose of their interests by will in the event that they predeceased their mother, the life tenant. The Tax Court attempted to distinguish this case from *Keinath* on the basis of this power of appointment, holding that the disclaimant did possess an indefeasible interest.<sup>38</sup> The Eighth Circuit, however, refused to find a distinction between the two cases and reaffirmed its *Keinath* rationale.<sup>39</sup>

The United States Court of Appeals for the Ninth Circuit also addressed

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33. *Keinath v. Commissioner*, 58 T.C. 352 (1972).

34. *Keinath*, 480 F.2d at 62.

35. *Id.*

36. *Id.* at 61.

37. 628 F.2d 1127 (8th Cir. 1980).

38. *Cottrell v. Commissioner*, 72 T.C. 489 (1979).

39. *Cottrell*, 628 F.2d at 1128. In its decision the *Cottrell* court noted:

The only distinction suggested is that here, unlike in *Keinath*, the taxpayer also had a general power of appointment by will. We hold that fact insufficient to distinguish *Keinath* for several reasons. If taxpayer, by her own act, had the right . . . to convert the defeasible interest into an indefeasible one, the Commissioner would have a point. But that was not the nature of the power given her. First the power was exercisable only 'by will duly admitted to probate.' Even if taxpayer exercised the power by making a will, the exercise might not ever become effective. A will creates no present rights . . . . It can be revoked, either by destruction or the making of a later will. Even if not revoked, it may never be admitted to probate . . . . And in the present case, the power was not even exercisable unless the taxpayer predeceased her mother, which did not happen. In these circumstances, we do not believe it can be said that the conditional testamentary power converted taxpayer's remainder into an interest 'indefeasibly fixed in quantity.'

the issue of timeliness in *Jewett v. Commissioner*.<sup>40</sup> Contrary to *Keinath*, however, the court held that a remainder interest can only be effectively disclaimed if it is made within a reasonable time from the moment the interest is created.<sup>41</sup> This is in sharp contrast with the Eighth Circuit's statement that the time begins to run when the remainder interest becomes "indefeasibly fixed both in quality and quantity."<sup>42</sup>

To resolve this conflict between the circuits, the Supreme Court granted certiorari in the *Jewett* case.<sup>43</sup> Justice Stevens, writing for the majority, affirmed the lower court's decision by holding that the meaning of the word "transfer" in the context of treasury regulation section 25.2511-1(c) refers to any gratuitous passage of property.<sup>44</sup> Furthermore, since there was no mention in the Code or regulations about a distinction between present and contingent future interests (or interests vested subject to divestment), the Court held that the term "transfer" must apply to each of these interests without variation.<sup>45</sup> Hence, since the taxpayer knew of the creation of the interest in 1939, he was unable to effectively disclaim that interest in 1972.<sup>46</sup>

The aforementioned situations provided a strong incentive for Congress to alter the federal tax laws concerning disclaimers as they existed prior to 1977. Congress enacted section 2518 to alleviate the strong dependence on state law and to clearly define the procedural time limit in which an interest may be disclaimed.<sup>47</sup>

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*Id.* at 1130. (footnote omitted).

It should be noted that even though I.R.C. § 2518 had already been enacted, the interest was created prior to 1977; thus, the earlier law applied. See *supra* note 15.

40. 638 F.2d 93 (9th Cir. 1980), *aff'd*, 455 U.S. 305 (1982). For an in-depth discussion of *Jewett*, see Note, *Jewett v. Commissioner: Unforeseen Crisis of Disclaimers*, 14 LOY. U. CHI. L.J. 166 (1982).

41. *Jewett*, 638 F.2d at 96.

42. *Keinath*, 480 F.2d at 63.

43. 452 U.S. 905 (1981).

44. *Jewett v. Commissioner*, 455 U.S. 305, 311 (1982). See Note, *supra* note 40.

45. *Jewett*, 455 U.S. at 312.

46. *Id.* at 318.

47. The House Committee on Ways and Means stated that:

If the requirements of the provision [I.R.C. § 2518] are satisfied, a refusal to accept property is to be given effect for Federal estate and gift tax purposes even if the applicable local law does not technically characterize the refusal as a 'disclaimer' if the person refusing the property was considered to have been the owner of the legal title to the property before refusing acceptance of the property.

H.R. REP. NO. 1380, 94th Cong., 2d Sess. 66, reprinted in 1976 U.S. CODE CONG. & AD. NEWS 3356, 3421. This passage demonstrates the congressional intent to reduce an effective disclaimer's dependence on state law. In practice, however, state law continued to govern many aspects of a federal disclaimer.



## II. POST-1976 DISCLAIMERS: THE IMPLEMENTATION OF SECTION 2518

Section 2518 of the Internal Revenue Code was enacted in 1976 and applies to the disclaimer of any interest created after December 31, 1976.<sup>48</sup> In order to effectively disclaim under section 2518(b), the refusal to accept must be "irrevocable and unqualified"<sup>49</sup> and also meet the following four requirements: (1) the refusal must be in writing;<sup>50</sup> (2) the refusal must be received by the transferor of the interest nine months after the later of (a) the creation of the interest or (b) the day on which the disclaimant reaches the age of 21;<sup>51</sup> (3) the disclaimant must not have accepted the interest or any of its benefits;<sup>52</sup> and (4) the interest must pass without any direction on the part of the disclaimant and must pass to either (a) the spouse of the decedent or (b) to a person other than the disclaimant.<sup>53</sup>

### A. The Writing Requirement

The writing requirement of section 2518(b)(1) was the first step taken by Congress to reduce uncertainty in the disclaimer laws. Prior to this section, the Code simply stated that the disclaimer must be effective under local law.<sup>54</sup> This was interpreted to mean that the disclaimer should be procedurally proper under local law.<sup>55</sup> Thus, if a state allowed oral renunciations, then this was also acceptable at the federal level. It now appears, however, that such a disclaimer would be ineffective under section 2518(b)(1). Proposed regulation section 25.2518-2(b)(1) states that the disclaimer must be written, it must identify the interest being disclaimed, and it must be signed by the disclaimant or his legal representative.<sup>56</sup> The ties to local law, however, were not severed totally because the proposed regulations also state that the writing must be received by the transferor in accordance with local law requirements for an effective delivery.<sup>57</sup>

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48. Tax Reform Act of 1976, *supra* note 8, § 2009(e)(2), at 1896.

49. I.R.C. § 2518(b) (1984).

50. *Id.* § 2518(b)(1).

51. *Id.* § 2518(b)(2). The disclaimer may also be received by the transferor's legal representative or the legal titleholder of the property.

52. *Id.* § 2518(b)(3).

53. *Id.* § 2518(b)(4).

54. Proposed Treas. Reg. § 25.2511-1(c) (1980).

55. See *supra* notes 26-30 and accompanying text.

56. Proposed Treas. Reg. § 25.2518-2(b)(1) (1980).

57. *Id.* § 25.2518-2(b)(2). The disclaimer must be received by the transferor within nine months. Furthermore, posting is not sufficient to constitute delivery. See Proposed Treas. Reg. § 25.2518-2(c) (1980).

## B. The Timeliness Requirement

### 1. The Various Provisions

As previously noted, prior to the enactment of section 2518, a person had a "reasonable time after the knowledge of the existence of the transfer" in which to disclaim an interest.<sup>58</sup> Section 2518(b)(2), however, brought about major changes to the old rule.

The new section provides that a person past the age of majority, twenty-one according to the statute, had to disclaim his interest in property within nine months of the "transfer" creating the interest. This nine month rule clearly abolished the subjective standard of reasonableness set out in treasury regulation section 25.2511-1(c). The commencement of this new time period is to be determined by referring to each separate taxable transfer as it is deemed completed.<sup>59</sup> An inter vivos transfer is completed when there has been a valid transfer for federal gift tax purposes, and a testamentary transfer is finalized at the date of the decedent's death.<sup>60</sup> When either of these two conditions are met, the nine month period begins to run.

The proposed regulations also abolish the holding in *Keinath* by declaring "[w]here the transfer is for the life of an income beneficiary with succeeding interests to other persons, both the life tenant and the other takers, whether their interests are vested or contingent, must disclaim within 9 months after the original taxable transfer."<sup>61</sup> This section is an excellent example of Congress' quest for uniform treatment and consistency under section 2518, but, as we shall see, the timing requirement still leaves many questions unanswered.

When the transferor creates a general power of appointment, for example, the nine month period to disclaim begins at different times depending upon the status of the disclaimant. In the case of the original recipient of the general power of appointment, a disclaimer must be made within nine months of the creation of the power. However, if the potential disclaimant receives an interest by virtue of the power being exercised, i.e., as an appointee, or if the person receives an interest due to the lapse of a general power of appointment, i.e., taker by default, then the potential disclaimant has nine months from the lapse or exercise by the holder of the general

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58. I.R.C. § 2511. See *supra* notes 31-47 and accompanying text.

59. Proposed Treas. Reg. § 25.2518-2(c)(2) (1980).

60. *Id.*

61. *Id.* See Proposed Treas. Reg. § 25.2518-2(c)(3), ex. 4 (1980) which states that if *A* establishes a trust that declares *B* the income beneficiary for life, remainder to *C* if then living, but if *C* is not living then remainder to *D* or *D*'s estate, and each beneficiary had reached the age of majority, then to constitute an effective disclaimer, *B*, *C*, and *D* must disclaim within nine months of the establishment of the original interest. *Id.*

power of appointment in which to effectively disclaim his interest.<sup>62</sup>

Consider the following however. If transferor *A* creates a special power of appointment to *B* which may be exercised in favor of *C* and/or *D*, then *B*, the holder of the special power of appointment, *C* and *D*, the permissible appointees, and any potential takers in default must disclaim within nine months after the *creation* of the power.<sup>63</sup>

In addition to the confusion surrounding disclaimers made in the context of powers of appointment, there is one major exception to the nine month requirement of section 2518(b)(2)(A) found in the provision dealing with disclaimers by minors.<sup>64</sup> If the potential disclaimant is under twenty-one years old, he may disclaim his interest within nine months after his twenty-first birthday, even though the interest may have been created several years before.<sup>65</sup> Further, the disclaimer will still be considered valid even though the disclaimant had actually received benefits from the property before reaching twenty-one providing those benefits were given without any action on his part.<sup>66</sup> The proposed regulations, however, also state that "if an individual retains the fee ownership of property or an undivided interest in property for more than nine months beyond the age that individual has the legal capacity, under applicable state law, to disclaim such interest, the individual has accepted the benefits of the interest."<sup>67</sup> This means that if the state age of majority is eighteen and the child receives a fee interest in the property at that time, then he is unable to take advantage of the privileges given him under section 2518(b)(2)(B) and the proposed regulations upon reaching twenty-one.<sup>68</sup>

## 2. *The Unsolved Problems of the Timing Requirement*

Although section 2518 made major advances in the uniform treatment of taxpayers, many gaps remain. The section still relies heavily on state law for answers. The implementation of the nine month time limit provides much more guidance to the estate planner than the reasonable time standard; yet it appears that if a state statute has a shorter time period within which to disclaim, the federal time period will be reduced to the shorter period because of the underlying idea that the federal disclaimer must be effective under

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62. Proposed Treas. Reg. § 25.2518-2(c)(2), (c)(3) ex. 2 (1980).

63. Proposed Treas. Reg. § 25.2518-2(c)(2) ex. 1 (1980).

64. I.R.C. § 2518(b)(2)(B) (1984).

65. *Id.*

66. Proposed Treas. Reg. § 25.2518-2(c)(1)(ii) (1980).

67. *Id.*

68. See Frimmer, *Proposed Regs Under Section 2518 Explain and Expand the Federal Disclaimer Statute*, 53 J. TAX'N 266-67 (Nov. 1980).

local law.<sup>69</sup> It is also safe to say that the federal requirement imposes a maximum time limitation. Thus, the time within which to disclaim may vary from six months to nine months, depending upon the state in which the interest was created.<sup>70</sup>

Although the termination of the distinction between present and future interests may promote consistent treatment among taxpayers, this interpretation of section 2518 places an extremely harsh burden on the holder of a contingent remainder interest. The section forces the holder to make a decision to accept or refuse property he may never own. Furthermore, section 2518 requires that the holder of the future interest evaluate the potential appreciation or depreciation of a piece of property he may not receive until many years later when his financial status may be substantially different from his present situation. This is especially burdensome when one considers the fact that knowledge is no longer necessary to trigger the time period for disclaiming.

Theoretically, a person would have to write a disclaimer to each of his relatives and friends every nine months to avoid being subject to ownership of these interests. Although an absurd example, this clearly illustrates the unfair position in which section 2518 places the holder of a future interest without knowledge. It seems that such a situation cannot be justified if the old common law principle upon which disclaimers were founded still stands.<sup>71</sup> One critic of section 2518 writes, "the statute's timing rule appears to extend unnecessarily the time for disclaiming some future interests. For example, the rule permits recipients of future interests in revocable trusts to defer decisions about acceptance or rejection even though donees of irrevocable future interests must decide within nine months."<sup>72</sup> It is inconsistencies such as these that highlight the many problems of the federal disclaimer law.

### C. *The Acceptance of Benefits*

Perhaps the element most closely intertwined with the philosophy and principles supporting a disclaimer is the acceptance of benefits. Surely one trying to avoid all interest and ownership of property would also want to disavow the receipt of any benefits as proof of his intention to disclaim. Under section 2518 one cannot either expressly or impliedly accept benefits

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69. Frimmer, *supra* note 68, at 267. See Proposed Treas. Reg. § 25.2518-1(c)(1) (1980).

70. *Id.*

71. See *supra* notes 4-5 and accompanying text.

72. Martin, *supra* note 4, at 332.

from a property interest without nullifying an otherwise valid disclaimer.<sup>73</sup> A disclaimant, however, is not deemed to have accepted property solely because state law says that title vests immediately upon the death of the decedent.<sup>74</sup> This, practically speaking, eliminates all distinctions between testate and intestate property found at common law, thereby freeing the disclaimant to make an effective federal disclaimer of an intestate share.

#### D. The Passing Requirement

The final element of an effective disclaimer is set out in section 2518(b)(4).<sup>75</sup> The section provides that the potential disclaimant must not direct the disclaimable interest to another.<sup>76</sup> Further, the disclaimant may not receive any benefit from the property by disclaiming it.<sup>77</sup> The exception to this requirement is when the disclaimer is made by the decedent's surviving spouse.<sup>78</sup> In such a situation, the disclaimer will be effective if all of the other elements of a valid disclaimer are satisfied and the interest passes to the surviving spouse without any direction on the survivor's part.<sup>79</sup>

The proposed regulations also discuss the problem of a partial failure of a disclaimer.<sup>80</sup> This occurs where disclaimant has a right to receive all or part of the disclaimed property as a legal heir, residuary beneficiary, or by any other means, *and* does not disclaim such right. If the disclaimed interest in property is not severable, the entire interest is treated as passing to the disclaimant.<sup>81</sup> This is quite different from the old rule that disallowed a renun-

73. Proposed Treas. Reg. § 25.2518-2(d)(2) (1980). See Proposed Treas. Reg. § 25.2518-2(d)(1)(iii) (1980).

74. Proposed Treas. Reg. § 25.2518-2(d)(2) (1980).

75. I.R.C. § 2518(b)(4) as originally enacted provided: "[A]s a result of such refusal, the interest passes to a person other than the person making the disclaimer (without any direction on the part of the person making the disclaimer)." Tax Reform Act of 1976, *supra* note 8, § 2009, at 1893. This section was amended in 1978. The new § 2518(b)(4) provided: "[A]s a result of such refusal, the interest passes without any direction on the part of the person making the disclaimer and passes either—(A) to the spouse of the decedent, or (B) to a person other than the person making the disclaimer." Revenue Act of 1978, Pub. L. No. 95-600, 92 Stat. 2763, 2935 (codified as amended at I.R.C. § 2518(b)(4) (Supp. IV 1980)).

The implementation of § 2518(b)(4)(A) allows a surviving spouse to make an effective disclaimer even if the individual receives an interest in the property, but only if the disclaimer is otherwise qualified under § 2518(b) and if the interest is not a result of any direction by the surviving spouse.

76. Proposed Treas. Reg. § 25.2518-2(e)(1)(i) (1980). It should be noted that mere precatory language does not harm an otherwise effective disclaimer if such language is given no legal effect by local law. Proposed Treas. Reg. § 25.2518-2(e)(4), (e)(5), ex. 8 (1980).

77. Proposed Treas. Reg. § 25.2518-2(e)(1)(ii) (1980).

78. *Id.* § 25.2518-2(e)(2).

79. *Id.* § 25.2518-2(e)(5), ex. 4-6. See *supra* note 75. See Frimmer, *supra* note 68, at 269.

80. Proposed Treas. Reg. § 25.2518-2(e)(3) (1980).

81. *Id.* § 25.2518-2(e)(3)(i), (ii).

ciation if any benefits had been conferred upon the disclaimant.

### *E. Partial Disclaimers*

If all the requirements of section 2518(b) are followed, a person may make a valid disclaimer of an *entire* interest in property while retaining a separate interest in the same property.<sup>82</sup> Thus, it is now possible under section 2518(c) to disclaim all or an undivided portion of either an income interest or a beneficial interest in the corpus.<sup>83</sup> Although seemingly sweeping, the Internal Revenue Service (Service) has carefully limited the right to partially disclaim an interest through the many examples found in the proposed regulations.

Since the term "undivided portion" was not clearly defined by Congress in section 2518(c), the Service has grasped this opportunity to limit the application of this section. For example, all beneficial interests in property are treated as one interest; hence, it is impossible to disclaim a testamentary general power of appointment while retaining an inter vivos power to invade the principle or vice versa.<sup>84</sup> If the transferor arranges the separate property interests for the purposes of avoiding the limitations of the statute, all of the interests will be treated as if they were a single interest.<sup>85</sup> The Service takes the final step by defining an undivided portion for themselves. Proposed treasury regulation section 25.2518-3(b) states that an undivided portion "must consist of a fraction or percentage of each and every substantial interest or right owned by the disclaimant in such property and must extend over the entire term of the disclaimant's interest in such property and in other property into which such property is converted."<sup>86</sup>

The section pertaining to partial disclaimers is an extremely innovative and helpful provision for the estate planner. Because of the numerous restrictions set forth in the proposed regulations, however, the disclaimant should be well advised before proceeding carelessly through this section.

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82. Proposed Treas. Reg. § 25.2518-3(a)(1)(i) (1980). The regulations provide that all income interests are considered to be one interest, and all beneficial interests in the corpus as another.

83. *Id.*

84. Proposed Treas. Reg. § 25.2518-3(d), ex. 9, 10 (1980).

85. *Id.* § 25.2518-3(a)(1). There is no indication in any of the legislative materials that Congress ever intended such a restriction.

86. *Id.* § 25.2518-3(b). The proposed regulation's construction of an "undivided portion" of a taxpayer's interests in property is consistent with the Service's definition of the identical language in I.R.C. § 170(f)(3)(B)(ii) (1984), which addresses charitable contributions and gifts. See Treas. Reg. § 1.170A-7(b)(1) (1984).

### III. THE ERTA AMENDMENT TO SECTION 2518

The change in administration resulting from the presidential election of 1980 brought sweeping revisions to all areas of the federal tax law. The disclaimer statute was not exempted from these changes. Under the Economic Recovery Tax of 1981 (ERTA),<sup>87</sup> all interests created after December 31, 1981 are subject to the following provision of section 2518:

(c)(3) Certain Transfers Treated as Disclaimers—For purposes of subsection (a), a written transfer of the transferor's entire interest in the property—(A) which meets requirements similar to the requirements of paragraphs (2) and (3) of subsection (b), and (B) which is to a person or persons who would have received the property had the transferor made a qualified disclaimer (within the meaning of subsection (b)), shall be treated as a qualified disclaimer.<sup>88</sup>

It was clearly Congress' intent when drafting the amendment to finally devise a uniform standard of federal disclaimers totally independent from state law.<sup>89</sup> Unfortunately, the amendment barely touches the surface of this problem, which has plagued the federal disclaimer from the beginning.

The focal point of 2518(c)(3) is clearly procedural. Under this provision a disclaimant may now technically take control of a property interest and give it to the person who would have received the interest had the disclaimant not taken control and thus make a regular qualified disclaimer under section 2518(b).<sup>90</sup> Stated another way, the disclaimant's conveyance of the property to the appropriate taker will not defeat the disclaimer simply because he did not execute a procedurally sound qualified disclaimer.

The disclaimant is still bound by the provisions of sections 2518(b)(2) and

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87. Pub. L. No. 97-34, 97 Stat. 172 (1981).

88. *Id.* § 426(b), at 318 (codified at I.R.C. § 2518).

89. S. REP. NO. 144, 97th Cong., 1st Sess. 142, *reprinted in* 1981 U.S. CODE CONG. & AD. NEWS 105, 241-42 [hereinafter cited as S. REP. NO. 144]. The Senate report provides that:

Prior to the enactment of section 2518, the effect of a disclaimer, for Federal estate and gift tax purposes, depended on its validity under applicable local law. When Congress enacted section 2518, it intended to create a uniform Federal standard so that a disclaimer would be effective for Federal . . . purposes whether or not valid under local law.

Under section 2518, however, because the disclaimer must be effective to divest the disclaimant of ownership, and pass the interest without direction on the part of the [disclaimant], the disclaimer must still satisfy local law. Because applicable law varies from State to State, there is still no uniformity.

The committee believes that a disclaimant should be able to perfect an otherwise valid disclaimer by directing that the interest pass to the person who would have received the property had the refusal been effective under local law.

*Id.*

90. I.R.C. § 2518(c)(3) (1984).

(3),<sup>91</sup> but it appears that the writing requirement and the “passing to” element have been substantially relaxed. Thus, under this section, if a husband *H* conveyed an income interest to his wife *W* for life, remainder to their son *S*, *W* could create a qualified disclaimer if she conveyed the income interest to *S*. If the conveyance occurred after nine months from the creation of the interest, however, or if *W* had derived any benefit from the property, the disclaimer would not be valid. *W* can act only in a ministerial capacity and presumably can only pass the property to the legal taker, and therefore, may not direct the property to someone other than the legal taker.

The major weakness in the new disclaimer legislation is that state law is still a very important factor in the procedure. Section 2518(c)(3)(B) mandates that the disclaimer can only be effective if the transfer is made to “a person or persons who would have received the property had the transferor made a qualified disclaimer.”<sup>92</sup> The identity of the transferee, however, remains unclear. The Senate Report indicates that “[s]tate disclaimer rules will be used to determine the transferee.”<sup>93</sup> As noted earlier, the intent of Congress upon enacting section 2518(c)(3) was to break the ties to state law, yet in the same breath, it declares that state law must be consulted to resolve the heart of the new amendment.

The problem does not stop at this point. What happens when state disclaimer laws do not cover the disclaimer of a particular type of interest, or if the state statute specifically holds a type of interest not disclaimable, or if the particular disclaimer is found to be invalid? In these situations it is highly unlikely that the state disclaimer law will provide the federal disclaimant with any guidance concerning the conveyance of an interest to the “person who would have received the property.”

The state time limit may also have an effect on the identity of the transferee for federal disclaimer purposes. If the state law allows disclaimers only up to six months from the creation of the interest, then it is possible to have a valid federal disclaimer but an ineffective state disclaimer. In this situation, once again state law will probably not identify the legal taker when confronted with an ineffective disclaimer.

#### IV. SUMMARY

There are three different sets of federal disclaimer laws: (1) for interests created prior to January 1, 1977 the disclaimer is governed by section 2511

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91. *Id.* Subsections (b)(2) and (3) address the timeliness and acceptance of benefits issue. For a discussion of these elements, see *supra* notes 55-71 and accompanying text.

92. I.R.C. § 2518(c)(3)(B) (1984).

93. S. REP. NO. 144, *supra* note 89, at 242.



and treasury regulation section 25.2511(c);<sup>94</sup> (2) for interests created between 1977 and 1981 section 2518 prevails;<sup>95</sup> and (3) interests created after December 31, 1981 are controlled by the amended version of section 2518.

When confronted with a potential disclaimer, the estate planner must be sure to consider three critical issues. First, the interest to be renounced should be defined. Next, determine how (procedurally) to disclaim the interest. Finally, establish when the interest must be disclaimed.

Interests created prior to 1977 rely heavily upon state law to determine the three aforementioned issues.<sup>96</sup> Remember, treasury regulation section 25.2511-1(c) said that a federal disclaimer must first meet local law requirements. Thus, the type of interest to be disclaimed was extremely dependent upon state law.<sup>97</sup> If a particular interest could not be disclaimed at the local level, as was the case of an intestate share, then it was not permitted to be disclaimed at the federal level.<sup>98</sup>

Section 2511 was also very much controlled by state law for the procedural aspects of a federal disclaimer.<sup>99</sup> Once again the treasury regulation called for effectiveness under local law,<sup>100</sup> and once again the procedure for a federal disclaimant hinged upon the quirks of the fifty states.

The timeliness aspect of a pre-1977 disclaimer paralleled the inconsistencies found in the other elements. A potential disclaimant had to be very careful to consider the reasonableness of the disclaiming time and also to document when knowledge of the creation of the interest was acquired.

The Tax Reform Act of 1976 gave the potential disclaimant some relief from the problems of section 2511. Section 2518, however, was filled with its own problems of inconsistent treatment. Congress did intend to reduce the need for consulting state law when it drafted section 2518.<sup>101</sup> By stating in subsection (b)(4) that the interest must pass "without any direction"<sup>102</sup> on the part of the disclaimant, however, and by not providing a way to complete the transfer, Congress forced section 2518 to be dependent upon local law.<sup>103</sup> Therefore, as one scholar has noted, the issue of what type of inter-

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94. See *supra* note 14.

95. See *supra* note 15.

96. Treas. Reg. § 25.2511-1(c) (1983).

97. See *supra* notes 20-25 and accompanying text.

98. See *supra* note 25 and accompanying text.

99. See *supra* notes 26-30 and accompanying text.

100. See *supra* notes 15-19 and accompanying text.

101. JOINT COMM. ON INTERNAL REVENUE TAXATION, *supra* note 31, at 3420-21. See Martin, *supra* note 4, at 325 n.39.

102. I.R.C. § 2518(b)(4) (1984).

103. Martin, *supra* note 4, at 323-35.

est may be disclaimed reverts back to local law.<sup>104</sup> Hence, the treatment of different types of interests will vary according to the appropriate state law.

Procedurally, section 2518 does much better than its predecessor statute. The four elements of section 2518(b)<sup>105</sup> give some guidance as to how to disclaim an interest, but, as previously discussed, there are still many situations causing inconsistent treatment to taxpayers based solely on state law.

Finally, if one looks carefully at the time requirements of section 2518 the state law dependency will eventually appear. Because a disclaimer had to be effective under local law to create a qualified disclaimer at the federal level, both time requirements may be less rigid than they appear. Local statutes must be consulted when the time period for a state disclaimer is less than the nine month federal provision; and a conflict definitely exists in many states that do not provide for postponing the time period until the disclaimant reaches majority.

The evolution of the disclaimer is far from complete, but it is encouraging to see that Congress has finally made some headway. It appears that the new amendment, a product of an overall tax scheme that promised liberalization and benefits to all, is a gallant attempt to free the disclaimant from some of the unduly harsh consequences of the past. The implementation of section 2518(c)(3) substantially loosens the procedural burdens of its predecessor, but unfortunately does nothing to solve the problems of timeliness, and varying treatment of different types of interests under state law. There is nothing inherently wrong with the inconsistent treatment of taxpayers under the federal tax laws. In fact, the situation occurs quite often. There is, however, something capricious about the inconsistent treatment of taxpayers based solely upon the state in which they live. The greater a law's dependency on state statutes the more inconsistent the treatment will be.

## V. RECOMMENDED SOLUTIONS

It is clear that although the ERTA amendment is a step in the right direction, the goal of uniformity has not been achieved. To achieve consistent treatment of taxpayers the timeliness problems must be resolved. If the federal rule under section 2518 is followed in all instances, uniformity will result. Thus, the time to disclaim an interest in property should be nine months with the aforementioned extended period for those under twenty one.<sup>106</sup> Further, the "age of majority" language should be eliminated from the statute. If this is done there can be no doubt as to when a person may

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104. *Id.*

105. *See supra* text accompanying notes 49-53.

106. I.R.C. § 2518(b)(2) (1984). *See supra* text accompanying notes 64-68.

disclaim. The problems surrounding the situation in which a state age of majority varies depending upon what the person is doing will be resolved.

The time period in which to disclaim should begin to run with the *later* of knowledge of a potential property ownership or the date the interest was created. There should also be no distinction between vested interests, vested interests subject to divestiture, contingent interests, or expectancies when determining when the time period begins to run. The changes, particularly the reinstatement of the knowledge requirement, would give all potential disclaimants a fair opportunity to discover and evaluate their interests or potential interests before they are precluded from disclaiming. These changes would eliminate the need from constantly disclaiming to persons likely to leave the disclaimant a property interest and would certainly give all disclaimants an equally "reasonable" time in which to disclaim.

Another change that would aid in achieving uniform treatment of taxpayers is to totally disregard state laws relating to disclaimable property. Any interest should be disclaimable. After all, the purpose of allowing a disclaimer is to give a person the right to refuse ownership in property.<sup>107</sup> Why should this right be curtailed depending upon what type of interest the person receives? By disregarding state laws that disallow disclaimers of certain interests, such as the intestate problems mentioned earlier,<sup>108</sup> uniformity would result.

To resolve the problem of defining the transferee local law must be used. Since a disclaimer, by definition, is the unqualified refusal to accept property rights, however, the only permissible direction of these should be the state law that sets forth the distributees of intestate property. Any other construction would create a direction of the property. Although this solution may not achieve total uniformity because state intestacy laws may vary, at least there would be a concrete standard for determining who is the transferee.

As stated earlier, the ERTA amendment to section 2518 was Congress' best effort to date to achieve uniformity. The implementation of any or all of the above suggestions, however, would substantially improve the present federal disclaimer legislation and bring it closer to the stated goal of consistent treatment of taxpayers.

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107. See *supra* text accompanying note 5.

108. See *supra* notes 18-25 and accompanying text.